(6)

No. 86-71

In The

Supreme Court of the United States

October Term, 1986

CTS CORPORATION,

Appellant,

v.

DYNAMICS CORPORATION OF AMERICA,

Appellee.

On Appeal from the United States Court of Appeals
For the Seventh Circuit

BRIEF FOR APPELLANT CTS CORPORATION

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QUESTIONS PRESENTED

1. Whether the Control Share Acquisitions Chapter of the Indiana Business Corporation Law, IND. CODE §§ 23-1-42-1 to -11 (1986), which makes the voting rights of "control shares" in covered Indiana corporations subject to a majority vote of all shareholders other than the acquiring person and incumbent management, is preempted by the Williams Act, 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f), which regulates only disclosures to shareholders and the purchase of shares in tender offers.

2. Whether the Control Share Acquisitions Chapter, which does not discriminate against interstate commerce or out-of-state residents, applies only to Indiana corporations with other substantial ties to the State, and regulates shareholder voting rights as a matter of the State's general corporation law governing the internal affairs of Indiana corporations, is unconstitutional under the Commerce Clause.*

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* *Rule 34.1(b) and Rule 28.1 Listings:* The required information was provided in the Jurisdictional Statement of Appellant CTS Corporation at 1 n.1, and remains accurate.

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OPINIONS AND JUDGMENTS BELOW

The final opinion of the United States Court of Appeals for the Seventh Circuit (the "Seventh Circuit"), issued June 9, 1986, is published at 794 F.2d 250 and is set forth in the Appendix To Jurisdictional Statement Of Appellant CTS Corporation ("CTS App.") at A1.[1] The Seventh Circuit's judgment, entered April 23, 1986, is set forth in CTS App. at A126. The two opinions of the United States District Court for the Northern District of Illinois (the "District Court"), issued April 9 and April 16, 1986, are published together at 637 F. Supp. 389 and are set forth in CTS App. at A29 & A88. The District Court's judgment, entered April 16, 1986, is set forth in CTS App. at A138.

JURISDICTION

The judgment of the Seventh Circuit held that the Indiana Business Corporation Law's Control Share Acquisitions Chapter, IND. CODE §§23-1-42-1 to -11 (1986), was unconstitutional under the Supremacy and Commerce Clauses of the Constitution of the United States. (CTS App. at A126.) The Supreme Court has jurisdiction of this appeal pursuant to 28 U.S.C. § 1254(2). On July 16, 1986, appellant CTS Corporation ("CTS") filed in the Seventh Circuit its notice of appeal to this Court (CTS App. at A133), and the appeal was docketed in this Court on July 22, 1986, both within 90 days of the Seventh Circuit's judgment as required by 28 U.S.C. § 2101(c) and SUP. CT. R. 10.3, 12.1.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

This appeal involves the following constitutional provisions and statutes, the texts of which are set forth in

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[1] On November 17, 1986, this Court entered its order granting appellant CTS Corporation's motion to dispense with the requirement of a joint appendix in this cause.

CTS App. as indicated:

1. The Commerce Clause, U.S. CONST. art. I, § 8, cl. 3 (CTS App. at A140).
2. The Supremacy Clause, U.S. CONST. art. VI, cl. 2 (CTS App. at A140).
3. The Williams Act amendments to the Securities Exchange Act of 1934, 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (CTS App. at A141).
4. The Control Share Acquisitions Chapter, IND. CODE §§ 23-1-42-1 to -11 (1986), of the Indiana Business Corporation Law (CTS App. at A167).

STATEMENT OF THE CASE

A. General Background.

CTS is an Indiana corporation with its principal place of business in Indiana. (R. 98 at ¶ 6.)[2] Appellee Dynamics Corporation of America ("DCA") is a New York corporation with its principal place of business in Connecticut. (R. 52a at ¶ 5; R. 56a at ¶ 3.) On March 10, 1986, DCA, then the beneficial owner of approximately 9.7 percent of the outstanding shares of CTS's single class of common stock, announced a combination partial tender offer and proxy contest. (R. 98 at ¶¶ 5, 76.) DCA's tender offer sought one million shares of CTS stock, which would give it approximately 27.5 percent of the outstanding CTS shares. (R. 98 at ¶ 76.) DCA's proxy contest sought to replace CTS's board of directors with a slate proposed by DCA at CTS's annual shareholders meeting (the "Annual Meeting"), then scheduled for April 25, 1986. (R. 54a at p. 3; R. 45 at App. 3 (Schedule 14D-1); R. 98 at ¶ 16.)

On March 4, 1986, prior to DCA's announcement,

[2] Documents in the record before the Seventh Circuit in Nos. 86-1601 and 86-1608 are designated by their number on the docket sheet in the record. The record is cited here in the form "R. ___ at p. ___" or "R. ___ at ¶ ___," to indicate first, the document number and second, the page or paragraph number.

the Governor of Indiana signed into law the new Indiana Business Corporation Law, IND. CODE §§ 23-1-17-1 to 23-1-54-2 (1986), a comprehensive revision of the State's generic corporation code. Mandatory application of the new law to Indiana corporations begins August 1, 1987, but corporations may elect to be governed by it before that date. *See* IND. CODE § 23-1-17-3. On March 27, 1986, CTS elected to be covered by the new law effective April 2, 1986. (R. 52a at ¶ 103; R. 45 at pp. 35-36.) The courts below held unconstitutional the Control Share Acquisitions Chapter of the new law, IND. CODE §§ 23-1-42-1 to -11 (the "Control Share Chapter").

B. The Control Share Chapter.

The Control Share Chapter governs the voting power of "control shares" in corporations chartered under Indiana law. "Control shares" are any shares that, when added to the acquiring person's previous holdings, pass any one of three thresholds – 20, 33.3 or 50 percent – of voting strength in electing the corporation's board of directors. IND. CODE § 23-1-42-1. The Control Share Chapter applies to an "issuing public corporation," defined in IND. CODE § 23-1-42-4(a) as an Indiana corporation that has:

(1) 100 or more shareholders;

(2) its principal office, principal place of business or substantial assets in Indiana; and

(3) either more than 10 percent of its shares owned by Indiana residents, more than 10 percent of its shareholders resident in Indiana, or at least 10,000 shareholders resident in Indiana.[3]

Substantively, the Control Share Chapter does not

[3] The term "corporation" as used in the Control Share Chapter is defined for purposes of the entire Indiana Business Corporation Law as "a corporation for profit that is not a foreign corporation." IND. CODE § 23-1-20-5. Though the District Court had

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restrict or otherwise regulate the purchase or sale of control shares, whether in a tender offer or otherwise. Rather, the Chapter provides that "[c]ontrol shares acquired in a control share acquisition have the same voting rights as were accorded the shares before the control share acquisition only to the extent granted by resolution approved by the shareholders of the issuing public corporation." IND. CODE § 23-1-42-9(a). The one million shares sought (and later purchased) by DCA pursuant to its tender offer put DCA over the 20 percent threshold. Under the Control Share Chapter, therefore, the voting power of those "control shares" must be determined by a shareholder vote that excludes "all interested shares." The Chapter defines "interested shares" as shares owned by officers of the corporation, directors who are also employees of the corporation, and the acquiring person. IND. CODE §§ 23-1-42-9(b)(2) (shareholder vote) & -42-3 (defining "interested shares"). Thus, under the Chapter, DCA may not vote its newly-acquired shares until it receives a majority vote of approval by the remaining CTS shareholders who are affiliated with neither CTS management nor DCA.

The Control Share Chapter creates a mechanism for a prompt vote by the disinterested shareholders on the voting rights of the control shares. At any time before, during or after its acquisition of control shares, the acquiring person may file an "acquiring person statement" with the company. IND. CODE § 23-1-42-6. At the acquiring person's request, a special shareholders meeting to decide the voting rights of the control shares must be held no later than 50 days after the corporation receives the statement. IND. CODE § 23-1-42-7. The Control Share Chapter leaves the acquiring person free to purchase the shares either before or after the shareholder vote. If no special meeting is requested by the acquiring person, the issue will be decided at the next special or annual shareholders meeting. IND. CODE § 23-1-42-7(c). In this case, there is no indication in the record that DCA filed an acquiring person statement, requested a special meeting or ever intended to do either.

The Control Share Chapter applies to all control share acquisitions of the stock of covered Indiana corporations, regardless of the State of residency of the acquiring person. Similarly, the statute applies regardless whether the control shares are acquired in intrastate or interstate commerce, or through a tender offer, open market or private purchases, gift or otherwise.[4]

C. Proceedings In The Courts Below.

On March 10, 1986, DCA filed this action in the District Court, originally against CTS and three of its directors, alleging claims unrelated to this appeal. (R. 1.)[5] On March 27, CTS filed an action against DCA in the Superior Court of Marion County, Indiana (the "Indiana Action"), seeking a declaratory judgment that the Control

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erroneously concluded that the Control Share Chapter could be applied to foreign corporations, the Seventh Circuit corrected this error and held, as the plain language provides, that the Chapter applies only to Indiana corporations. (CTS App. at A104-05, A19.) DCA now apparently concedes that the District Court's conclusion on this issue was mistaken. (*See* Motion of Appellee Dynamics Corporation of America to Affirm ("Motion To Affirm") at 5-6.)

[4] The Chapter does not apply to control shares acquired under "the laws of descent and distribution" or in satisfaction of a pledge or security interest. IND. CODE § 23-1-42-2(d). CTS's Jurisdictional Statement at 5, 20, erroneously stated that the Chapter applies in the case of inheritance.

[5] DCA's original complaint, filed the day it announced its combination partial tender offer and proxy contest, alleged an "illegal proxy scheme" in violation of the Federal securities laws, claiming that CTS's communications to its

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Share Chapter was valid and would bar DCA from voting at the Annual Meeting any control shares it might acquire. (R. 52a at ¶¶ 115-16; R. 54a at Exhibit B.)

On March 31, 1986, four days after CTS filed the Indiana Action, DCA moved for leave to file its Third Amended Complaint in this action, adding as Count VIII a claim alleging that the Control Share Chapter is unconstitutional under (a) the Supremacy Clause, because it is allegedly preempted by the Williams Act amendments to the Securities Exchange Act of 1934, 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (the "Williams Act"); and (b) the Commerce Clause. (R. 51a at ¶ 7; R. 52a at ¶¶ 101-17.) DCA simultaneously moved for a temporary restraining order and preliminary injunction against CTS's "enforcement" of the Control Share Chapter, including enjoining CTS from prosecuting the Indiana Action. (R. 51a.)[6] On April 4, DCA filed a supplemental memorandum stating that the relief it now sought was a judicial "declaration" that the Control Share Chapter was unconstitutional. (R. 55b at p. 1.) CTS, in addition to opposing DCA's constitutional claims on the merits, objected to any immediate decision on the constitutional issues because, *inter alia*, the Attorney

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shareholders were "designed" to "jump the gun" on the 1986 Annual Meeting and "to condition the CTS shareholders" to vote to retain the present directors. (R. 1.) Through March 27, DCA filed two amended complaints alleging additional claims and adding director defendants; CTS filed an answer and counterclaim; and the District Court denied DCA's motion for a temporary restraining order on its original claim. (R. 22, 42, 45, 39.) None of these matters is involved in the instant appeal.

[6] On April 2 and 3, 1986, District Judge Milton Shadur, acting as temporary emergency judge, heard intermittent oral argument on DCA's motions. During argument on April 3, Judge Shadur orally granted DCA's motion for leave to file its Third Amended Complaint. (*See* CTS App. at A43.) The transcript of that argument is not contained in the record on appeal.

General of Indiana had not been notified of the claim as required by 28 U.S.C. § 2403(b); no opportunity for an evidentiary hearing had been afforded; and CTS's time to answer the Third Amended Complaint had not even run. (R. 67 at pp. 5-8.)

Nevertheless, the District Court issued a Memorandum Opinion and Order on April 9, 1986, granting "DCA's motion for declaratory relief" on Count VIII of the Third Amended Complaint and ruling that the Control Share Chapter, as applied to DCA's specific plans, was preempted by the Williams Act. (CTS App. at A29, A87.) After CTS moved the District Court to certify its judgment on Count VIII as final and appealable pursuant to FED. R. CIV. P. 54(b), the District Court on April 16 *sua sponte* issued a second Memorandum Opinion and Order, which (a) stated that, if the Indiana Attorney General had been notified of the constitutional issues pursuant to 28 U.S.C. § 2403(b), the District Court would also have held the State statute unconstitutional under the Commerce Clause; (b) certified the District Court's judgment on Count VIII pursuant to Rule 54(b); and (c) "certified the appeal" of its judgment on Count VIII to the Indiana Attorney General. (CTS App. at A88, A124-25.)

CTS's appeal to the Seventh Circuit pursuant to 28 U.S.C. § 1291 was expedited in view of the imminent Annual Meeting. (CTS App. at A131.)[7] On April 23, 1986, the Seventh Circuit issued both its judgment affirming the District Court and an order briefly describing its action, stating that a full opinion would issue later.

[7] The Seventh Circuit's opinion, like its original order, erroneously states that the appeal in No. 86-1601 was pursuant to 28 U.S.C. § 1292(a)(1) (appeal of grant or denial of preliminary injunction). (CTS App. at A2, A130.) On April 17, 1986 (the day after its second opinon on the constitutional claim and the Rule 54(b) certification of its judgment on Count

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(CTS App. at A126, A129.) On June 9, 1986, the Seventh Circuit issued its final opinion, holding, *inter alia*, that the Indiana Control Share Chapter is unconstitutional both on Supremacy Clause grounds (broader than those recited by the District Court) and under the Commerce Clause.[8]

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VIII), the District Court had entered a preliminary injunction against CTS on DCA's separate State law claim involving a CTS shareholder rights plan, and had denied CTS's motion for a preliminary injunction against DCA based on alleged Federal securities law violations. CTS then separately appealed those District Court rulings in No. 86-1608, and the two appeals were consolidated by the Seventh Circuit. The appeal of the District Court's orders on the preliminary injunction motions (involving issues not presented to this Court) was pursuant to 28 U.S.C. § 1292(a)(1); however, the appeal of the constitutional issues presented here was from the District Court's final judgment on Count VIII (CTS App. at A124-25, A138), and was therefore pursuant to 28 U.S.C. § 1291.

[8] The following matters, while not appearing in the appellate record before the Seventh Circuit in the instant appeal, have transpired since the Seventh Circuit's judgment:

(a) On April 24, 1986, DCA purchased one million CTS shares pursuant to its tender offer and now owns approximately 27.5% of CTS's outstanding stock, thereby triggering the terms of the Control Share Chapter. *See Dynamics Corp. of America v. CTS Corp.*, 635 F. Sup. 1174, 1178 (N.D. Ill. 1986).

(b) The CTS Annual Meeting was rescheduled and held on May 16, 1986. *See Dynamics Corp. of America v. CTS Corp.*, 638 F. Supp. 802, 804 (N.D. Ill.), *aff'd in part and vacated and remanded in part*, No. 86-1888 (7th Cir. Nov. 3, 1986). All of DCA's shares were voted at the meeting, in violation of the Indiana statute but as required by the Seventh Circuit's decision. Nevertheless, DCA's proxy contest was unsuccessful and CTS's incumbent directors were re-elected. DCA then

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SUMMARY OF ARGUMENT

This case arises amid a continuing policy debate about the economic, political and social effects of hostile corporate takeovers.[9] Resolving that debate, however, is not what this case is about. Nor does this case turn on the issue presented but not definitively resolved in *Edgar v. MITE Corp.*, 457 U.S. 624 (1982) – namely, the extent to which the States have continuing authority to regulate the purchase and sale of shares in tender offers, the subject matter of the Williams Act. Rather, the heart of this case is whether Federal law bars the States from developing their generic corporation laws in ways that do *not* restrict or regulate the purchase or sale of securities or any other transaction in interstate commerce, but that may (depending on the intentions of a potential bidder) make

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filed new claims in the District Court seeking to overturn the election, but the District Court denied DCA's request for a preliminary injunction setting aside the election results. *Dynamics Corp. of America v. CTS Corp.*, 643 F. Supp. 215 (N.D. Ill. 1986).

(c) DCA's motion for a preliminary injunction against enforcement of a second CTS shareholder rights plan was denied by the District Court in a decision that has now been partially vacated by the Seventh Circuit. *Dynamics Corp. of America v. CTS Corp.*, 638 F.Supp. 802 (N.D. Ill.), *aff'd in part and vacated and remanded in part*, No. 86-1888 (7th Cir. Nov. 3, 1986).

[9] *Compare, e.g.*, Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981), *with, e.g.*, Bebchuck, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1693 (1985). In recent weeks, the debate over the merits of hostile takeover activities has intensified and has begun to shift from an academic to a Congressional forum, due to disclosures involving insider trading in takeover battles. *See, e.g.*, Ingersoll, *Political Pressures Growing to Stem Trading Excesses*, Wall St. J., Nov. 17, 1986, at 15, col. 5.

a State's domestic corporations less attractive as hostile takeover targets.

The Seventh Circuit's decision striking down the Indiana Control Share Chapter ignored the settled principles of Federalism that govern this case in favor of that court's own economic theorizing (based on *no* record evidence) about the possible impact of the Chapter on the practical calculations of a takeover bidder. Rather than focusing on the constitutional issues actually presented – *i.e.*, whether the Indiana statute in fact conflicts with the Williams Act, or in fact impermissibly burdens interstate commerce – the Seventh Circuit reasoned, in essence, that the statute is unconstitutional merely because it may make Indiana corporations less desirable as hostile takeover targets, and thereby disrupt an interstate "market for corporate control."

The Seventh Circuit's Supremacy and Commerce Clause analysis is unprecedented and its decision is wrong. With respect to preemption, there is no conflict between the provisions of the Indiana Control Share Chapter and those of the Williams Act. The Indiana statute does not even address disclosures to shareholders and the purchase and sale of securities, and it imposes no delay or other restriction whatever on a tender offeror's ability to purchase shares.

The Seventh Circuit's holding that the Control Share Chapter is preempted by the Williams Act despite the absence of any conflict between the statutes rests on a supposed policy of "neutrality" between takeover bidders and target companies inferred from isolated observations in the legislative history of the Williams Act. The "neutrality" observations, however – which at most reflect Congress's intent with respect to *Federal* law in enacting the Williams Act – are far too ambiguous to support preemption even of State statutes that, unlike the Control Share Chapter, *do* regulate the purchase and sale of securities. But even if the "neutrality" observations were a sufficient basis to

preempt some State laws dealing with the same subject matter as the Williams Act, they certainly cannot preempt State corporation laws addressed to other subjects merely because such laws may make a State's domestic corporations economically less attractive to a potential takeover bidder. The Seventh Circuit's contrary view would lead directly to the "Federalization" by the courts of vast areas of corporation law.

Nor does the Indiana Control Share Chapter violate the Commerce Clause. The Chapter does not discriminate in any way against interstate commerce. In addition, since the statute applies only to Indiana corporations with other substantial ties to the State, it poses no threat whatever of multiple and inconsistent State regulations of the same transactions. For these reasons alone, the Chapter satisfies every criteria of validity established by this Court's Commerce Clause decisions.

Even if the "balancing test" articulated in *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970), were applicable here, the Control Share Chapter easily survives Commerce Clause scrutiny. The Chapter serves the legitimate State interest of protecting non-dominant shareholders in Indiana corporations by allowing them to vote on a fundamental change in the corporation – its transformation from a company owned by scattered shareholders to one controlled by a single dominant shareholder. Any extra-territorial effects of the statute are constitutionally insignificant, arising only from the fact that non-residents are also free to purchase shares of Indiana corporations. Even if the Seventh Circuit were correct in believing that the Chapter will not produce an economically efficient market for allocating corporate assets – an issue over which there is substantial academic debate and on which there is no evidence in the record – this Court has expressly rejected the view that the Commerce Clause requires the States to create economically efficient markets. *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 127-

28 (1978).

The *Exxon* holding applies with particular force when, as here, the market involves property rights that exist at all only because the State has first created and defined them in its generic corporation law. The Commerce Clause does not require the States to establish corporations at all, much less to define the property rights of a corporate share in ways that may be familiar to a given Federal court, or may be preferred by a given in-State or out-of-State investor. So long as Indiana does not discriminate against out-of-State residents or interstate commerce, it is free (as it has done in the Control Share Chapter) to define the property rights of the shares of its domestic corporations as its legislature sees fit, regardless whether that definition may make those property rights less attractive to a takeover bidder.

Neither the Seventh Circuit's disagreement with the Indiana legislature about the social and economic value of hostile takeovers nor its doubts about the policy wisdom of the Control Share Chapter render that statute unconstitutional. Contrary to the Seventh Circuit's view, the two controlling questions presented by this case involve not economics but Federalism. First, did the Congress, in enacting the Williams Act, make a political decision to bar the States from developing their generic corporation laws in ways that do *not* restrict or regulate the purchase or sale of securities, but that may make the State's domestic corporations less attractive as hostile takeover targets? Second, if the Congress made no such decision, should the "dormant " Commerce Clause nonetheless be construed to impose that same result as a matter of constitutional law?

Appellant CTS respectfully submits that the answer to both questions is "no," and that the judgment below should be reversed.

ARGUMENT

I. THE CONTROL SHARE CHAPTER IS NOT PREEMPTED BY THE WILLIAMS ACT.

The ordinary presumption of constitutionality given to State laws is strongest in the preemption context. To preserve the States' lawmaking authority, the starting assumption is "that Congress did not intend to displace state law." *Maryland v. Louisiana,* 451 U.S. 725, 746 (1981). Preemption is disfavored "in the absence of persuasive reasons – either that the nature of the regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained." *Chicago & North Western Transportation Co. v. Kalo Brick & Tile Co.,* 450 U.S. 311, 317 (1981). Where there is no "irreconcilable conflict" with Federal law and the nature of the subject matter does not require exclusive Federal regulation, preemption may be based only on "an unambiguous congressional mandate to that effect." *Florida Lime & Avocado Growers, Inc. v. Paul,* 373 U.S. 132, 142-47 (1963).

Because the Control Share Chapter deals only with a matter traditionally governed by State law – the voting rights of shares in Indiana corporations – the presumption against preemption in this case is especially strong. "Where . . . the field which Congress is said to have preempted has been traditionally occupied by the States, . . . 'we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.' " *Jones v. Rath Packing Co.,* 430 U.S. 519, 525 (1977) (quoting *Rice v. Santa Fe Elevator Corp.,* 331 U.S. 218, 230 (1947)). Here, however, the Seventh Circuit held preempted a law that governs *only* the voting rights of shareholders in the internal affairs of corporations chartered by the State – matters *not* addressed by the Williams Act and traditionally matters of *exclusive* State concern.

A. The Williams Act Does Not Preempt State Law Absent A Direct Conflict With Federal Law, And There Is No Such Conflict In This Case.

The 1968 Williams Act added sections 13(d), 13(e), 14(d), 14(e), and 14(f), 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f), to the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a to 78kk (the "Exchange Act"). The Williams Act amendments govern disclosures and statements in connection with tender offers to purchase shares, Exchange Act §§ 13(d), 14(d), 14(e) & 14(f); require or prohibit certain acts so that investors will have sufficient time to decide whether to tender their shares, *id.* §§ 13(e) & 14(d); and impose substantive requirements on tender offerors' purchases of shares, *id.* § 14(d).

None of these statutory provisions expresses *any* limit on State authority. Instead, all are subject to Section 28(a) of the Exchange Act, which provides that the Act does *not* preempt State laws that do not "conflict with" the "provisions" of the Exchange Act. 15 U.S.C. § 78bb(a). Section 28(a) "was plainly intended to protect, rather than to limit, state authority." *Leroy v. Great Western United Corp.*, 443 U.S. 173, 182 (1979).[10] Thus, the only *statutory* expression of Congressional intent is that the Williams Act is *not* intended to displace State regulation of tender offers in the absence of a direct and unavoidable conflict.

The Seventh Circuit did not base its preemption holding on any such direct conflict. The closest it came to identifying a "conflict" was its claim that, because the disinterested shareholder vote on the voting power of control shares might not take place until up to 50 days after an "acquiring person statement" is filed, a tender offeror would in practice wait beyond the 20 business day (*circa*

[10] DCA has sought to avoid the force of § 28(a), claiming that it is an old provision intended to preserve only State Blue Sky laws.

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28 calendar day) *minimum* Williams Act waiting period before purchasing the shares. The Seventh Circuit's assertion that this "impose[s] a 50-day delay on tender offers" (CTS App. at A20) is inaccurate, and there is no "conflict" with Federal law for at least three reasons.

First, the Control Share Chapter and the shareholder vote place no legal restraints whatever on the acquiring person's right to purchase shares (whether in a tender offer or otherwise), and a tender offeror is wholly free to purchase shares at *any* time permitted by the Williams Act. A legally cognizable "conflict" with Federal law cannot be manufactured by speculations about a State statute's possible impact upon a tender offeror's economic or strategic calculations – *i.e.*, its *willingness* to purchase before knowing whether the shares will be granted voting rights by disinterested shareholders.

Second, the Williams Act's approximately 28-day waiting period is only the *minimum* period a tender offer *must* be kept open. Even the maximum 50-day period for the shareholder vote under the Indiana statute is well within the Williams Act's *maximum* 60-day limit (at which time tendering shareholders must be given withdrawal rights under Federal law, 15 U.S.C. § 78n(d)(5)). Accordingly, even if speculation about a tender offeror's economic and strategic calculations could be the basis for a legal

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(Motion To Affirm at 12 n.9.) In fact, § 28(a) was amended as recently as 1982 to clarify its effect on State "bucket-shop" laws. 96 Stat. 1409 (1982). More important, the scope of § 28(a) is obviously not limited to Blue Sky laws. This Court has recognized, in language directly applicable here, that § 28(a) allows State and Federal securities regulation to "co-exist," *SEC v. National Securities, Inc.*, 393 U.S. 453, 461 (1969), and that "state law continues to apply where the [Exchange] Act itself does not," *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware*, 414 U.S. 117, 138 n.16 (1973).

"conflict" (and it cannot), there is still no conflict with the Williams Act. The Control Share Chapter poses *no* threat of the "indefinit[e]" and therefore "unreasonable" delay emphasized by Justice White in considering the Illinois statute in *MITE,* 457 U.S. 624, 637-39 (1982) (opinion of White, J.).

Third, under the Control Share Chapter, a tender offeror in fact can purchase the shares after the Williams Act's *minimum* waiting period *and* without risk concerning voting rights of the shares it acquires. As explained at greater length in the Brief for the State of Indiana, a tender offeror need only structure its offer in one of a number of possible ways so as to retain the option of returning the shares if it is later unsuccessful in acquiring voting rights.[11]

DCA takes the "conflict" argument to absurd lengths, asserting that the Chapter conflicts with the Williams Act "because it was impossible for DCA's tender offer to comply with its provisions even though [DCA] satisfied all of the requirements of the Williams Act." (Motion To Affirm at 9.) DCA's argument is wrong for each of two reasons. First and most obvious, State statutes are not preempted merely because they impose legal requirements *in addition* to those imposed by Federal law. Parallel State and Federal regulation of securities transactions, for example, has long been recognized. *See, e.g., SEC v. National Securities, Inc.,* 393 U.S. 453, 461 (1969). Rather, State laws are

[11] The parties disagree whether, under the Control Share Chapter, voting rights for DCA's control shares must be approved not only by disinterested shareholders but also by a majority of all CTS shares including "interested shares." CTS and the State of Indiana contend that IND. CODE § 23-1-42-9(b)(1) requires a second, simultaneous vote of *all* shares only where the proposed acquisition would effect certain changes in the capital structure of the company, such as changing the number of shares of stock,

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preempted only where the act of complying with Federal law *requires* violation of State law, or *vice versa. See Florida Lime & Avocado Growers,* 373 U.S. at 142-43. No such conflict is present here.

Second, DCA's "impossibility" argument involves only its particular, self-chosen strategy for taking control of CTS – namely, a partial tender offer (for approximately 17 percent of CTS's outstanding shares) *combined* with a *proxy contest* at the 1986 Annual Meeting. The "impossibility" contention has nothing to do with DCA's consummation of its *tender offer,* but rather concerns only DCA's desire to vote the acquired shares at a specific annual meeting in the context of a proxy battle it chose to initiate. Thus, any "impossibility" arose solely from DCA's choice of tactics and timing, not from any conflict between the Indiana statute and the Williams Act. A particular tender offeror's strategy in a particular takeover attempt is not entitled to constitutional priority over State law.

11 *(Continued)*
creating a new class of shares or altering the rights of a class of shares. *See* IND. CODE § 23-1-38-4(a). The District Court and Seventh Circuit disagreed; yet the District Court denied CTS's motion for *Pullman* absention on the constitutional claims, and the Seventh Circuit affirmed that denial. (CTS App. at A53-55, A19).

Assuming *arguendo* that approval by a majority of all shares is also required, this should not affect the constitutional issues. Presumably, it would be easier for DCA to win a majority of all shares since it would be able to vote its own "interested shares" in the second vote. This is particularly true since DCA alleged that its own investment in CTS stock was "enormous" while CTS's incumbent management owned but an "insignificant" amount. (R. 52a at ¶ 22.) Similarly, the Seventh Circuit observed that officers' and inside directors' "aggregate shareholdings will often be small." (CTS App. at A20.) If the constitutional issues do turn on this question of Indiana law, however, the denial of abstention was error.

Indeed, DCA's "impossibility" claim reveals the central flaw of its entire argument. At bottom, DCA's preemption theories rest on the novel – and false – assumption that it has a Federal right *immediately* to vote shares acquired in a tender offer. Patently, however, State law – *not* Federal law – governs the scheduling of and voting rights at shareholder meetings of the State's domestic corporations. For example, State law governs when shareholder meetings may be held, *e.g.*, IND. CODE § 23-1-29-1 (annual meeting must be held at time stated in or fixed in accordance with bylaws), and may provide that only shareholders of record as of a certain date may vote, *e.g.*, IND. CODE § 23-1-29-7 (bylaws or board of directors may provide for record date up to 70 days before vote). DCA's argument, however, leads to the absurd result that an annual meeting provision that did not permit a tender offeror to vote acquired shares "immediately" after the Williams Act minimum waiting period would also be preempted, or that a record date provision or any other State statute that might slow down a tender offeror's chosen timetable also impermissibly "conflicts" with Federal law. DCA's choice of tactics and timing, however, cannot create any "conflict" between the Williams Act and the Control Share Chapter; and this was not even the basis for the Seventh Circuit's decision.

B. The Control Share Chapter Is Not Preempted By Any Supposed Policy of "Neutrality" Unexpressed In The Statutory Provisions Of The Williams Act.

Rather than relying on any direct conflict between the State and Federal statutes, the Seventh Circuit based its preemption holding on its claim that the Control Share Chapter upsets "a delicate balance between the contending factions in the takeover controversy." (CTS App. at A23.) The Seventh Circuit's analysis rests on two essential premises, neither of which is correct.

The first premise is that the Williams Act implicitly

requires the States to maintain a policy of "neutrality" between incumbent management and the bidder in tender offers, and thus preempts State statutes that do not actually conflict with Federal statutory provisions but nonetheless "favor" one side or the other in the contest. That proposition is based solely on a debatable view of the legislative history of the Williams Act – a view that was accepted by three Justices in *MITE*, 457 U.S. at 634 (opinion of White, J., joined by Burger, C.J., and Blackmun, J.); rejected by two others, *id.* at 646-47, 655 (Powell, J., and Stevens, J.); and not addressed by the remaining four.

The second necessary premise is that this "neutrality" policy extends beyond the scope of the matters actually regulated by the Williams Act (*i.e.*, disclosures to shareholders and the purchase and sale of shares), and reaches other State corporation laws that may affect a bidder's practical calculations or willingness to make a hostile takeover bid. The Seventh Circuit's decision thus "Federalizes" State corporation law to the extent that any State statute will be preempted if a court concludes that it may, by some uncertain standard, "unduly" affect the desirability or outcome of either a tender offer itself or a tender offeror's post-acquisition plans for the target. Neither Justice White's opinion in *MITE* nor any lower court decision, before this one, has gone so far in extending the reach of Federal law into the internal affairs of corporations created by the States' own laws.

1. The Legislative History Of The Williams Act Does Not Support Any Preemption Of State Laws.

As noted above, there is no conflict between the Control Share Chapter and any Williams Act provision. Nor does the Williams Act itself express any Congressional intent otherwise to preempt State law. To the contrary, the pertinent provision of the Exchange Act, Section 28(a), reflects quite the opposite intention. Therefore, CTS respectfully submits at the outset that State law should

never be invalidated on the basis of a "Federal policy" discernible only, if at all, from a Federal statute's debatable legislative history.

The "political safeguards" of our Federal system require a clear and unambiguous political decision by the Congress to oust the States from legislating in an area. *See Garcia v. San Antonio Metropolitan Transit Auth.*, 469 U.S. 528, 550-55 (1985) (relying on political process to preserve State sovereignty). Such a political decision should be evident on the face of the Federal statute itself. An "unambiguous congressional mandate," *Florida Lime & Avocado Growers, Inc.*, 373 U.S. at 147, or an "unmistakabl[e]" Congressional decision, *Chicago & North Western Transportation Co.*, 450 U.S. at 317, is required. These political safeguards of our Federalism would fail of their essential purpose if courts were free to invalidate State laws on the basis of perceived "policy judgments" the Congress itself did not consider sufficiently important to enact into positive law. *Cf. Pennhurst State School and Hospital v. Halderman*, 465 U.S. 89, 99 (1984) (requiring "unequivocal expression of congressional intent" to overturn States' Eleventh Amendment immunity under Fourteenth Amendment). If this Court agrees, this is the end of the preemption issue in this case.

Furthermore, even if legislative history alone could theoretically oust the States from legislating in an area, the legislative history of the Williams Act is far too ambiguous a basis for doing so here. At most, that legislative history indicates only that the Congress did not want *Federal* law to upset the "balance between the contending factions in the takeover controversy." This simply does not support the far broader proposition of the Seventh Circuit (and of Justice White's opinion in *MITE*) that Congress at the same time implicitly prohibited the States from taking any steps that might affect that balance. Whatever the Williams Act's legislative history indicates about Congress's intentions for *Federal* policy toward takeovers,

that history provides *no* foundation for the second and far more dramatic step of preempting *State* laws in the absence of a direct conflict.

This Court's decision in *Piper v. Chris-Craft Industries, Inc.*, 430 U.S. 1, 26-35 (1977), explained the context of the Congressional "balance." As the *Piper* Court observed, the bill as first introduced was intended to protect incumbent corporate management from cash tender offers, a strategy that had not been regulated by Federal securities laws until passage of the Williams Act. In committee hearings, however, witnesses "indicated . . . that takeover bids could often serve a useful function." *Id.* at 30. Sensitive to the suggestion that the bill would favor one side or the other in control contests, the Williams Act sponsors "made it clear that the legislation was designed solely to get needed information to the investor," *id.* at 30-31, and that they had " 'taken extreme care to avoid tipping the scales either in favor of management or in favor of the person making the takeover bids.' " *Id.* at 31 (quoting 113 CONG. REC. 24664 (1967) (remarks of Sen. Williams)).

Placed in context, these references to neutrality on the part of *Congress* do not support the conclusion that the Williams Act also implicitly barred the *States* from affecting the "balance of power" between the tender offeror and the target:

> Congress was indeed committed to a policy of neutrality in contests for control, *but its policy of evenhandedness does not go either to the purpose of the legislation* or to whether a private cause of action is implicit in the statute. *Neutrality is, rather, but one characteristic of legislation directed toward a different purpose – the protection of investors.* Indeed, the statements concerning the need for Congress to maintain a neutral posture in takeover attempts are contained in the section of the Senate Report entitled, "Protection of Investors." Taken in their totality, these statements confirm that what Congress had in mind

> was the protection of shareholders, the "pawn[s] in a form of industrial warfare." The Senate Report expressed the purpose as "plac[ing] investors on an equal footing with the takeover bidder," Senate Report 4, without favoring either the tender offeror or existing management.

430 U.S. at 29-30 (emphasis added). Hence, the references to "neutrality" suggest only that Congress *itself* did not wish to "tip the balance" with the Williams Act, not that Congress intended the Act to be a comprehensive scheme regulating tender offers to the exclusion of State authority. The neutrality references in the legislative history thus fall far short of the "unambiguous congressional mandate" required to justify preemption.

The Seventh Circuit acknowledged that "it is a big leap from saying that the Williams Act does not itself exhibit much hostility to tender offers to saying that it implicitly forbids states to adopt more hostile regulations." (CTS App. at A22.) Nonetheless, it relied on Justice White's and its own opinions in *MITE* and on subsequent lower court decisions to justify that "big leap," stating that "whatever doubts . . . we might entertain as an original matter are stilled by the weight of precedent." (CTS App. at A23.) The "weight of precedent" is not at all persuasive here, however, because a majority of this Court has never accepted the proposition that the Williams Act forbids States from adopting any laws more hostile to takeovers.

The Seventh Circuit's further reliance on *Piper* and on *Schreiber v. Burlington Northern, Inc.*, 472 U.S. ___, 86 L. Ed. 2d 1 (1985), is plainly misplaced. In *Piper,* this Court expressly *rejected* the argument that the Williams Act created a "pervasive scheme of federal regulation of tender offers" that would support an implied cause of action, 430 U.S. at 29 – which is virtually a holding that Congress did *not* intend to oust the States from legislating in the area. *See Merrell Dow Pharmaceuticals Inc. v. Thompson,* 478 U.S. ___, 92 L. Ed. 2d 650, 662-63

& n.13 (1986). Similarly, the *Schreiber* Court *refused* to extend the Williams Act to regulate the substantive fairness of defensive strategies by the target corporation's board of directors, and instead expressly left such matters to State corporation law. There was no suggestion in *Schreiber* that the State corporation law governing defensive strategies must also display an appropriate "neutrality" lest it encroach upon the Williams Act; yet that result is logically compelled by the Seventh Circuit's decision.

In short, a majority of this Court has never held (either in *MITE* or any other case) that whatever inferences of Congressional "neutrality" can be drawn from the Williams Act's legislative history implicitly require the States to be equally "neutral" in their own legislation governing their domestic corporations. To the contrary, a majority of this Court has consistently held that neither the Williams Act nor other Federal securities statutes evince any Congressional intent to "Federalize" corporation law beyond the specific subjects those statutes address. *E.g., Santa Fe Industries, Inc. v. Green,* 430 U.S. 462, 479 (1977). And in preemption cases generally, this Court has repeatedly held that Federal court invalidation of State laws on preemption grounds, one of the most sensitive areas of Federalism, requires unmistakable, unambiguous evidence that Congress so intended – evidence that the most expansive reading of the Williams Act's debatable legislative history cannot supply. For these reasons alone, the Indiana Control Share Chapter is not preempted by the Williams Act.

2. **Any Preemption Under The Supposed "Neutrality Principle" Must In Any Event Be Limited To The Subject Matter Of The Williams Act, And Cannot Preempt State Corporation Laws That Do Not Regulate The Purchase And Sale Of Securities.**

Even assuming that "neutrality" statements from the Williams Act's legislative history could preempt otherwise valid State laws, it still does not follow – as the Seventh Circuit effectively held – that *any* State laws making tender offers less attractive to the offeror are preempted. Rather, the scope of any preemption arising from that legislative history must be limited by the subject matter of the Williams Act.

Absent a direct conflict between State and Federal law, this Court's cases have necessarily limited preemption to those matters *actually regulated* by Federal statutes, and have not extended preemption to any State law that might touch on the area. For example, in *Huron Portland Cement Co. v. Detroit,* 362 U.S. 440, 444-46 (1960), the Court concluded that Federal laws governing inspection of steamship boilers did not preempt local air pollution regulations even though the local laws prohibited conduct allowed by Federal law. Because there was "no overlap" between the Federal and local laws, there was no preemption: "To hold otherwise would be to ignore the teaching of this Court's decisions which enjoin seeking out conflicts between state and federal regulation where none clearly exists." 362 U.S. at 446. *Accord, e.g., Rice v. Santa Fe Elevator Corp.,* 331 U.S. 218, 237 (1947) (no preemption where Federal and State laws related to different matters and any conflict was speculative).

The Williams Act and its legislative history address only a narrow subject – the interactions among tender offerors, incumbent management and investors up to the point when the investor makes an "informed choice"

whether to tender his shares. As Justice White said in *MITE,* "Congress sought to protect the investor not only by furnishing him with the necessary information but also by withholding from management or the bidder any undue advantage that could frustrate the exercise of an informed choice." 457 U.S. at 634.

The Control Share Chapter, by contrast, regulates only post-acquisition voting rights and addresses entirely different concerns. Unlike the Illinois statute in *MITE,* the Indiana statute does *not* prohibit, restrict or otherwise regulate disclosures to shareholders or the purchase and sale of shares. Instead, it allows a tender offeror or other acquiring person to purchase shares at any time permitted by Federal law, but protects the interests of other shareholders (*e.g.*, in a tender offer, the interests of shareholders who choose *not* to tender their shares) vis-a-vis a new and potentially dominant one. The Chapter is thus beyond the scope of whatever preemption might be mandated by the supposed "neutrality principle."

The Indiana legislature had legitimate reasons to be concerned with the situation where one shareholder acquires a dominant portion of voting shares. There is an inherent possibility of unfair treatment when a dominant (but not 100 percent) shareholder maintains the controlled corporation as a partly-owned subsidiary for some unspecified time. *See* Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 Harv. L. Rev. 1693, 1711 (1985) (dominant shareholder adopts such a strategy only to take "advantage of minority shareholders"). The Indiana Control Share Chapter allows dispersed shareholders in a firm with a new and potentially dominant shareholder to protect their interests by voting.

In so doing, the Chapter reflects a valid legislative concern for shareholder control over a fundamental event in the corporation's existence – the transformation of the corporation from a collection of dispersed shareholders to

one controlled by one dominant shareholder. If there is no shareholder vote and the dominant shareholder gains control of the board, the large group of remaining shareholders, "without its consent, is participating in a different enterprise as certainly as if there had been a merger with a third party." Brudney, *Equal Treatment of Shareholders*, 71 CAL. L. REV. 1072, 1122 (1983). The Control Share Chapter is thus squarely in the tradition of other State corporation statutes requiring shareholder votes on questions of fundamental corporate events such as mergers, dissolutions, sales of assets or changes in voting power of classes of shares – statutes that no one has seriously suggested are preempted by the Williams Act or other Federal securities statutes.[12]

The Seventh Circuit questioned at great length the substantive merits of the economic and policy decisions reflected in the Control Share Chapter – matters on which neither an academic nor a political consensus exists.[13] But the constitutional issue presented to the Seventh Circuit

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[12] The Control Share Chapter is also similar to legislation introduced in the 99th Congress by Senator Proxmire that would have required a two-thirds vote of a corporation's shareholders to approve a hostile takeover, while prohibiting the takeover bidder from voting its shares. *See* S. 706, 99th Cong., 1st Sess. (1985); 131 CONG. REC. S3243-48 (daily ed. Mar. 20, 1985) (statement of Sen. Proxmire). In the wake of recent revelations of insider trading in hostile takeovers, Senator Proxmire's proposal has received renewed attention. *See* Ingersoll, *supra* note 9.

Senator Proxmire's introduction of S. 706 in the last Congress underscores, of course, that neither the Williams Act nor other Federal securities laws deal with the concerns addressed by the Indiana legislature in the Control Share Chapter, and hence can scarcely preempt the Indiana statute.

[13] The substantive merits of the issues involved are extraordinarily complex, and particularly ill-suited to judicial (rather than legislative) resolution. Indeed, the Seventh Circuit's deci-

(Footnote continued on the following page)

(and to this Court) is *not* whether those decisions were wise or correct as a matter of policy or economics. Rather, the only relevant question as a matter of constitutional jurisprudence is whether, in our Federal system, those decisions were Indiana's to make.

The answer to that question is plain. One may debate whether the legislative history of the Williams Act im-

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13 *(Continued)*

sion, for all its focus on economics, ignores critical aspects of the economic forces that (in Professor Bebchuk's phrase) "distort" the choice faced by shareholders in responding to a hostile tender offer – particularly when the bidder attempts, as DCA did here, to obtain effective control by acquisition of less than all (and even less than a majority) of a corporation's shares. *See* Bebchuk, *supra* note 9, at 1717-33.

The Seventh Circuit's failure to analyze adequately even the economic impact of the Control Share Chapter is also illustrated by its apparent assumption that the Chapter is intended to protect incumbent management. (CTS App. at 25.) DCA makes the same assumption, asserting repeatedly that the Indiana statute is a "weapon" to defeat tender offers, "completely controlled by management." (*E.g.*, Motion To Affirm at 4-6, 7-8, 19-20.) Since the courts below decided the case without an evidentiary record, there is of course no evidentiary basis whatever for that claim. Moreover, it is impeached on the face of the statute itself, which (a) places the decision whether to accord voting rights to control shares in the hands of disinterested shareholders and *excludes* management; (b) requires a prompt shareholder vote at the instance of the acquiring person; (c) requires that notice of the meeting include the acquiring person's statement; and (d) contains nothing that prohibits the acquiror from communicating directly with the shareholders. *See* IND. CODE. § 23-1-42-7 & -8. If, as DCA maintains, tender offers in fact benefit all shareholders (*see* Motion To Affirm at 21-22), then one would expect disinterested shareholders to grant voting rights to the control shares and thus facilitate hostile takeovers. A statute that puts in the hands of the shareholders themselves the fate DCA claims will always benefit them is a curious "management entrenchment" device indeed.

plicitly preempts some State laws that also regulate disclosures to shareholders and the purchase and sale of securities. But in view of the narrow subjects regulated by the Williams Act, there is *no* basis for concluding that Congress made *any* political judgment to bar innovative State statutes that govern the voting power of shares in State-created corporations, or that deal with any other issue of corporation law not addressed by Williams Act regulation. To the contrary, Congress has traditionally left regulation of these internal corporate affairs to the State of incorporation. *Cort v. Ash*, 422 U.S. 66, 84 (1975). Indeed, the established validity of State authority to govern the internal affairs of corporations has led this Court to construe the Exchange Act narrowly so as *not* to "federalize . . . the law of corporations." *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 479 (1977). *Accord, Schreiber v. Burlington Northern, Inc.*, 472 U.S. ___, 86 L. Ed. 2d 1 (1985) (§ 14(e) does not apply to alleged breaches of fiduciary duty by incumbent board of directors in tender offer contest).[14]

The decision below violates that principle, and its necessary implications highlight the error committed. The list of State laws that could be preempted under the Seventh Circuit's analysis is remarkably long. The Model Business Corporation Act – followed by many States – has long authorized directors to determine the relative voting rights of classes and series of shares, a power that obviously can be used to discourage a tender offer. *See* MODEL

[14] Indeed, in 1984 Congress rejected proposed legislation that would have restricted defensive tactics in takeover contests, H.R. 5693, 98th Cong., 2d Sess. (1984), in part because the bill would have intruded on State corporation law. *See Annual Review of Federal Securities Regulation*, 40 BUS. LAW. 997, 1019-21 (1985). *See also* H.R. Rep. No. 1028, 98th Cong., 2d Sess. 9-17 (1984) (noting that Congress must address proper relationship between State and Federal law in regulating takeovers), and note 12, *supra*.

BUS. CORP. ACT § 16 (1969); REV. MODEL BUS. CORP. ACT §§ 6.01(c), 6.02 (1984). State laws restricting voting to persons who have held shares in the corporation for a certain length of time, *e.g.*, IND. CODE §23-1-29-7 (record date may be 70 days before vote), could also be preempted. Statutes requiring shareholder votes on fundamental corporate events – *e.g.*, mergers, IND. CODE. § 23-1-40-3, sales of assets, IND. CODE. § 23-1-41-2, and dissolutions, IND. CODE § 23-1-45-1 – could certainly interfere with a tender offeror's desired takeover scheme and thus be preempted. State laws governing the timing of shareholder meetings, *e.g.*, IND. CODE §§ 23-1-29-1 *et seq.*, or the election of directors, *e.g.*, IND. CODE §§ 23-1-33-1 *et seq.*, may affect a tender offeror's ability to take control of a target corporation and thus also become constitutionally suspect.

The Seventh Circuit's suggestion that Williams Act preemption is analogous to Federal labor law preemption further illustrates this problem, and in fact underscores the basic flaw in the preemption analysis applied below. In the labor area, as the Seventh Circuit stated, Congress indeed established a "delicate balance between contending factions," leaving the forces of the marketplace to resolve contests and forbidding any State regulation tipping the regulatory balance in either direction. (*See* CTS App. at A22-23.) *Cf. Machinists v. Wisconsin Employment Relations Comm'n*, 427 U.S. 132, 150 (1976) (Congress meant to leave collective bargaining to the "free play of contending economic forces"). But Congress did so by enacting detailed, *comprehensive* legislation governing all aspects of the collective bargaining process; by establishing the supervisory role of the National Labor Relations Board over that process; and by authorizing the courts to develop a Federal common law of labor contracts to fill any remaining legal gaps, *see Textile Workers Union v. Lincoln Mills*, 353 U.S. 448, 456-57 (1957).

In the area of corporation law, however, Congress has done nothing that even approaches establishment of such a

comprehensive statutory, regulatory and judicial scheme. To the contrary, *State* law has always provided the comprehensive regulation, and thereby establishes whatever "balance" exists between contending forces in the corporate law field (including, *inter alia*, the "balance" on questions involving the voting rights of shares and other aspects of the legal relationships among shareholders). The Federal securities laws, by contrast, are only "incomplete and interstitial' in nature," *Kaminsky v. Abrams*, 281 F. Supp. 501, 505 (S.D.N.Y. 1968), addressed primarily to the purchase and sale of shares in interstate commerce.[15]

Hence, the flaw in the Seventh Circuit's labor law analogy is that Federal law could establish a "comprehensive balance of power" in tender offers only by Federalizing all aspects of corporation law that might affect that balance. As noted earlier, those aspects would include, in addition to the voting rights of control shares, a well-nigh limitless list of topics traditionally governed by State corporate statutes – such as the scheduling and voting methods for election of directors; the fiduciary standards applicable to defensive tactics in a tender offer; and the rights of a newly dominant shareholder to undertake a merger, dissolution or sale of assets to consolidate its position. Neither the Williams Act nor any other Federal statute even begins to address these issues.

[15] That Congress has established no comprehensive Federal scheme in the securities field at all analogous to that created by Federal labor legislation is underscored by the fact that the Williams Act governs only tender offers, *see* 15 U.S.C. § 78n(d)(1), and does not reach open market or privately negotiated purchases of securities – tactics recently employed in hostile takeover battles that can result in changes in corporate control with minimal Federal regulation. *See Hanson Trust PLC v. SCM Corp.*, 774 F.2d 47, 52-57 (2d Cir. 1985) (25% of company acquired in two hours in five private purchases and one open market purchase); Hertzberg & Rundle, *Campeau's Victory In Battle For Allied Signals Big Changes In Takeover Tactics*, Wall St. J., Nov. 4, 1986, at 2, col.3 (open market purchase of 48% of company in one day). The introduction of legislation in recent Congresses that *would* create greater Federal regulation of takeover battles also demonstrates that such regulation does not currently exist. *See* notes 12 & 14, *supra*.

Under the Seventh Circuit's analysis, however, all of these matters would, under the guise of Williams Act preemption, become subject to Federal judicial control. The Federal courts, unguided by any Federal statutory provisions, would have to establish the appropriate "balance" for all of these elements of corporation law, and then decide whether State statutes or State court decisions impermissibly "tipped" that balance – all by reference to some comprehensive standard of "neutrality" manufactured out of wholly judicial cloth.

The only apparent alternative to assigning these political decisions to Federal judges would be to hold that the Williams Act "froze," as of 1968, all aspects of the then-existing corporation laws of 50 States that might affect the "balance of power" in hostile takeovers. Since the Williams Act addresses only disclosures to shareholders and certain tender offer techniques, the statute itself plainly cannot supply the remainder of the regulatory "balance" that Congress (under the Seventh Circuit's reasoning) supposedly desired when it passed that statute. If that remaining "balance" is not to be created entirely by the Federal courts, then the only other apparent source is the 50-State pattern of corporation law as it existed in 1968 – a view under which virtually any post-1968 change in State corporation might be held to "upset the balance" and thus be preempted.

Both alternatives are plainly untenable. Congress intended neither to authorize the Federal courts to develop a general, Federal corporation law, nor to "freeze" State corporation law as of 1968. The Williams Act was instead a narrow statute intended to fill a small gap in Federal

securities regulation. In filling that gap, Congress may not *itself* have intended to tip whatever takeover "balance" then existed under each State's corporation laws. It gave no indication, however, that it intended the Williams Act to be the final and comprehensive word on takeovers, either by creating a Federal common law of corporations or by freezing State corporation law as of 1968.

Even assuming, then, that the "neutrality" observations in the Williams Act's legislative history could have any preemptive force, that force must be limited to the subjects actually regulated by the Williams Act – disclosures to shareholders and the purchase and sale of shares. That subject matter might at least provide a baseline by which courts could determine whether State statutes regulating the same subjects are "neutral" or not. Taken outside that limited context and applied to State corporation laws generally, however, the "neutrality" observations lack any substantive content to guide their application by the Federal judiciary. They become instead a roving mandate for the Federal courts to adjudicate whether any State corporation statute that may "affect" the desirability of tender offers is sufficiently "neutral" – adjudications that will likely be informed, as was the decision below, by little more than a given court's view of the economic and policy merits of tender offers. There is no meaningful, judicially manageable or constitutionally acceptable way to extend the "neutrality principle," as the Seventh Circuit did here, to State corporation statutes that do not govern disclosures to shareholders and the purchase and sale of shares.

II. THE CONTROL SHARE CHAPTER DOES NOT VIOLATE THE COMMERCE CLAUSE.

The Control Share Chapter does not discriminate in any way against interstate commerce or out-of-State residents. It applies only to Indiana corporations that also have other substantial ties to the State. Nor does the statute prohibit or regulate purchases of shares, whether in interstate commerce or otherwise. Instead, it regulates only the post-acquisition voting rights of control shares, however acquired, in the internal affairs of Indiana corporations.

Since the Chapter does not discriminate against interstate commerce and (as it applies only to Indiana corporations) poses no risk of overlapping and inconsistent State regulations, it plainly does not violate the Commerce Clause. By holding that it does, the Seventh Circuit impermissibly extended the reach of the "dormant" Commerce Clause into the States' traditional regulation of the internal affairs of the corporations they create.

Even if application of the "balancing test" articulated by this Court in *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970), were proper in this case, it would not alter this conclusion. The Indiana statute serves the legitimate State purpose of protecting the interests of shareholders who may be adversely affected by a change in control of the corporation. Any indirect effects of the Chapter on interstate commerce are minor, especially since State law exclusively creates and defines the stock rights that are available for purchase in the first place. The Commerce Clause does not require the States to define shareholders' rights (or any other property rights) in any specific way, so long as the States do not discriminate against interstate commerce. The Seventh Circuit's holding to the contrary is unprecedented in Commerce Clause jurisprudence.

A. The Control Share Chapter Does Not Discriminate Against Interstate Commerce.

The first critical feature of the Control Share Chapter is that it does not discriminate against interstate commerce. The State's regulation of the voting rights of control shares does not turn on *any* feature of interstate commerce. The statute applies whether the Indiana corporation's control shares are acquired in intrastate or interstate

commerce, and whether through a tender offer, private or open market purchases or otherwise. Likewise, it applies regardless of the residences of the buyer and seller.

The Chapter therefore easily passes the most basic test of Commerce Clause analysis. This Court accords "special deference" to State laws that do not discriminate against interstate commerce, based on the sound assumption that where a law's "burden usually falls on local economic interests as well as other States' economic interests, [this ensures] that a State's own political processes will serve as a check against unduly burdensome regulations." *Kassel v. Consolidated Freightways Corp.*, 450 U.S. 662, 675 (1981) (plurality opinion). *Accord, Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 125-26 (1978) (no discrimination even where burden fell only on out-of-State businesses); *Huron Portland Cement Co. v. Detroit*, 362 U.S. 440, 448 (1960) (no discrimination).[16]

B. The Control Share Chapter Applies Only To Indiana Corporations And Poses No Risk Of Multiple And Inconsistent Burdens.

The second critical feature of the Control Share Chapter for Commerce Clause purposes is that it applies only to Indiana corporations with additional ties to the State. Therefore, the statute poses no risk of subjecting the corporation or a tender offeror to cumulative, multiple and inconsistent State regulations. In addition to discrimination, the presence or absence of this risk of multiple burdens plays the other major role in Commerce Clause jurisprudence. In *MITE*, for example, the Illinois statute

[16] The *Kassel* plurality concluded that this traditional deference was weakened where the State also created several exemptions that clearly reduced the burden of the regulations on its own residents. 450 U.S. at 676-78. The Indiana Control Share Chapter contains no such discriminatory exemptions.

at issue prohibited certain stock purchases pursuant to tender offers, and was not limited to corporations chartered under Illinois law. Hence, Justice White's opinion noted that "if Illinois may impose such regulations, so may other States; and interstate commerce in securities transactions generated by tender offers would be thoroughly stifled." 457 U.S. at 642.

Huron Cement made the same point: "State regulation, based on the police power, which does not discriminate against interstate commerce *or operate to disrupt its required uniformity*, may constitutionally stand." 362 U.S. at 448 (emphasis added). *See also Southern Pacific Co. v. Arizona*, 325 U.S. 761, 774 (1945) (striking down State limit on train length in view of "confusion and difficulty" resulting from conflicting State regulations); *Bibb v. Navajo Freight Lines, Inc.*, 359 U.S. 520, 529-30 (1959) (striking down one of conflicting State regulations on the shape of truck mud-flaps). In this case, there is obviously no need for national uniformity in shareholder voting rights (unlike, for example, railroad or trucking regulation). Furthermore, there is no risk of overlapping and inconsistent State regulation because the law of one State – and one State only –*must* define shareholder voting rights.

The absence of both discrimination against interstate commerce and any risk of overlapping and inconsistent State regulations should dispose of the Commerce Clause issue here. *See Huron Cement*, 362 U.S. at 448. Despite various formulations of the test, this Court has *never* struck down on Commerce Clause grounds State legislation that did not exhibit at least one of these features.[17]

[17] As one variant of the "multiple burden" aspect of Commerce Clause analysis , the Court has stricken State laws that "directly regulate" interstate commerce – such as the Illinois statute in

(Footnote continued on the following page)

C. The Control Share Chapter Serves Legitimate State Interests In Protecting Non-Dominant Shareholders In Indiana Corporations.

In *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970), this Court articulated a balancing test for "evenhanded" regulations "affecting" interstate commerce:

> Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.

In *Pike* itself, however, this "balancing test" was not applied, since that case involved a statute that discriminated on its face against interstate commerce (requiring produce grown in the State to be packaged there as well, *see* 397 U.S. at 145). Since *Pike,* this Court has applied this "balancing test" to invalidate State laws only where the threat of multiple and inconsistent burdens on interstate commerce existed. *E.g., Raymond Motor Transportation, Inc. v. Rice,* 434 U.S. 429, 441-46 (1978). *See generally* Regan, *The Supreme Court And State Protectionism: Making Sense Of The Dormant Commerce Clause,* 84 MICH. L. REV. 1091 (1986). Since the Indiana Control Share Chapter, which applies only to Indiana corporations, presents no threat whatever of multiple and inconsistent State regulations, CTS submits at the outset that the *Pike*

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17 *(Continued)*

MITE, which forbade the purchase and sale of shares nationwide, including transactions between wholly out-of-State parties. 457 U.S. at 641-42. *See also Brown-Forman Distillers Corp. v. New York State Liquor Auth.*, 476 U.S. ___, 90 L. Ed. 2d 552, 561-63 (1986). Indiana's Control Share Chapter, which does not regulate purchase and sale transactions at all, imposes no such restriction.

"balancing test" is wholly inapplicable here.[18]

Even assuming *arguendo,* however, that the *Pike* test applies at all in this case, the balance of interests is heavily in favor of the State statute. The Control Share Chapter protects non-dominant shareholders in Indiana corporations whose interests may be adversely affected by a change in control of the corporation. By permitting these shareholders to decide whether voting control of the corporation should change hands through acquisition of the

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[18] There are severe conceptual difficulties in applying the *Pike* "balancing test" in cases where there is no threat of multiple and inconsistent State burdens upon interstate commerce. The "values" or "interests" as between State law and interstate commerce are simply incommensurate, and a court attempting to strike the "balance" would be placed squarely in the proverbial (and plainly legislative) role of weighing "apples against oranges" – something this Court has consistently said it will not do. *See, e.g., Kassel v. Consolidated Freightways Corp.*, 450 U.S. 662, 670 (1981) (opinion of Powell, J., joined by White, Blackmun and Stevens, JJ.) ("if safety concerns are not illusory, the Court will not second-guess legislative judgment about their importance in comparison with related burdens on interstate commerce"); *id.* at 691 (Rehnquist, J., joined by Burger, C.J., and Stewart, J., dissenting) ("the Court does not directly compare safety benefits to commerce costs and strike down the legislation if the latter can be said in some vague sense to 'outweigh' the former. Such an approach would . . . arrogate to this Court the functions of forming public policy, functions which, in the absence of congressional action, were left by the Framers of the Constitution to state legislatures"); *Raymond Motor Transportation, Inc. v. Rice,* 434 U.S. 429, 450 (1978) (Blackmun, J., joined by Burger, C.J., and Brennan and Rehnquist, JJ., concurring) ("the Court does not engage in a balance of policies; it does not make a legislative choice"). Moreover, as this Court held only last term, even a State law that *discriminates* against interstate commerce will still survive constitutional scrutiny if it serves legitimate (*i.e.*, non-protectionist) purposes that

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control shares by a single dominant person, the statute serves the legitimate State purpose of protecting their interests and promoting shareholder control over fundamental changes in the corporation. As discussed at greater length earlier in addressing the Supremacy Clause issue, minority or dispersed shareholders are vulnerable to exploitation by a dominant shareholder who may run the corporation for its own benefit.

Indiana, like its sister States, has commonly required shareholder approval of fundamental changes in corporate affairs, a tradition continued by the new Indiana Business corporation Law. *See, e.g.,* IND. CODE §§ 23-1-38-3 (amendments to articles of incorporation); 23-1-40-3 (mergers and share exchanges); 23-1-41-2 (dispositions of substantial assets); and 23-1-45-2 (dissolutions). The Control Share Chapter's requirement of a disinterested shareholder vote reflects the Indiana legislature's conclusion that a single dominant shareholder's acquisition of a substantial block of shares is also a fundamental change for the corporation, and should also be subject to shareholder approval as to the voting rights of that block of shares. That legislative judgment should not be second-guessed by the courts when the statute neither discriminates against interstate commerce nor regulates any

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18 *(Continued)*

"could not be served as well by available nondiscriminatory means." *Maine v. Taylor*, 477 U.S. ___, 91 L. Ed. 2d 110, 121 (1986). There is no "second tier" balancing test by which the Court also "weighs" the State interest served by the discriminatory State law against the burden on interstate commerce. *See id.* at 121-129. Hence, to use a "balancing" test in cases that involve no threat of multiple and inconsistent burdens would, perversely, leave the courts freer to act as legislatures and invalidate State policy judgments with which they disagree – as happened here in the courts below – than in cases of *discriminatory* State laws that implicate the core values of the Commerce Clause.

interstate transaction in the first place.

The Seventh Circuit dismissed Indiana's interests as "trivial or even negative," saying that "Indiana has no interest in protecting residents of Connecticut from being stampeded to tender their shares to [DCA] at $43." (CTS App. at A25 (citing *MITE*).) That simplistic analysis elides both the far different context of *MITE* and the State's actual interests in the case at bar. Unlike the Illinois statute in *MITE*, the Indiana statute at issue here has utterly no effect on any shareholder's ability to *sell* his shares. Rather, the Control Share Chapter protects shareholders of Indiana corporations – both resident and nonresident and including those who decide *not* to tender or otherwise dispose of their shares – in the event of a potentially adverse change in voting control of the corporation.

The Seventh Circuit's reasoning also misreads Justice White's opinion in *MITE*, apparently relying on the following passage:

> While protecting local investors is plainly a legitimate state objective, the State has no legitimate interest in protecting nonresident shareholders. Insofar as the Illinois law burdens out-of-state transactions, there is nothing to be weighed in the balance to sustain the law.

457 U.S. at 644. That statement in *MITE* dealt with an Illinois statute that was *not* limited to Illinois corporations and that *did* regulate purchases and sales of shares between wholly out-of-State sellers and buyers. Indiana, however, obviously has a legitimate interest in protecting *all* shareholders of Indiana corporations in their relationships *inter sese,* including voting rights. More generally, the State is entitled to take steps to protect the investments of nonresidents as well as residents. That is a legitimate interest that necessarily inheres, in one form or another,

in the corporation code of every State.[19]

D. Any "Effects" Of The Control Share Chapter On Interstate Commerce Do Not Burden Such Commerce And Do Not Rise To Constitutional Significance.

The other factor to be weighed in the *Pike* "balancing test" is a State statute's burden on interstate commerce. Hence (assuming again that the *Pike* test applies here at all), the Control Share Chapter would violate the Commerce Clause only if it imposed a burden on interstate commerce that is "clearly excessive" in relation to the State's interest in protecting non-dominant shareholders. The "burdens" found by the Seventh Circuit, far from constituting the "excessive" interference with interstate commerce required by *Pike*, reflect fundamental misunderstandings both of State corporation law and of this Court's Commerce Clause jurisprudence.

The Seventh Circuit apparently recognized that the Control Share Chapter does not prohibit interstate commerce in equity securities. Rather, the heart of the Seventh Circuit's Commerce Clause analysis here was its judgment (based on *no* evidence) that the Indiana statute impedes a "commerce in corporate control" that the Seventh Circuit deemed "important." (CTS App. at

[19] So long as a State allows out-of-State residents to own shares in its domestic corporations (as it constitutionally must), then any State corporation law regulating voting rights or any other internal corporate relationship will necessarily have extraterritorial effects. To suggest that Indiana law should *discriminate* between voting rights of resident and non-resident shareholders would create (rather than avoid) constitutional problems. *See Supreme Court of New Hampshire v. Piper*, 470 U.S. 274, 280 (1985)(Privileges and Immunities Clause "'guarantees to citizens of State A [the privilege] of doing business in State B on terms of substantial equality with the citizens of that State,"' *quoting Toomer v. Witsell*, 334 U.S. 385, 396 (1948)).

A26.)[20] Specifically, the Seventh Circuit reasoned that the efficiency with which a corporation's assets are employed "depends on the market for corporate control – an interstate, indeed international, market that the State of Indiana is not authorized to opt out of, as in effect it has done in this statute." *Id.* Of course, this *ipse dixit* is simply wrong. Nothing in the Commerce Clause requires the States to create corporations at all, much less – as the Seventh Circuit held – to define the rights of shareholders so as to tie the voting rights of a share inextricably to the equity interest in the corporation's profits and property represented by a share.[21]

[20] In addition to the lack of any evidence supporting the Seventh Circuit's speculations about impact upon "commerce for corporate control," there is also no evidence to show (and no basis whatever to assume) that the Control Share Chapter will cause any reduction in the total "amount" of commerce, interstate or intrastate, in the equity securities of covered Indiana corporations. At most, there may be come *shift* in the persons doing the trading – *i.e.*, from tender offerors to other investors – an effect that is absolutely immaterial for Commerce Clause purposes. *See Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 127 (1978) ("interstate commerce is not subjected to an impermissible burden simply because an otherwise valid regulation causes some business to shift from one interstate supplier to another" ; "the Clause protects the interstate market, not particular interstate firms").

[21] This conclusion, implicit in the Seventh Circuit's opinion, was stated explicitly by the District Court: "Voting rights, after all, are an integral part of the ownership interest purchased along with a stock certificate." (CTS App. at A79.) "The value of the shares in control acquisitions is inseparable from their voting power." (CTS App. at A114.)

This stress on the importance of voting rights is more than a little ironic, since State law is the *source* of all such rights. The "one share, one vote" rule, for example, is neither universal nor constitutionally required. *See Providence & Worcester Co. v. Baker*, 378 A.2d 121, 123 (Del. 1977) (at common law each shareholder had one vote regardless of number of shares owned). Nothing in the Constitution would prohibit a State frcm

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The Seventh Circuit made two fundamental errors. First, Judge Posner's opinion mistakenly equates economic efficiency with constitutionality. But this Court's decision in *Exxon* makes clear that a State may impose "inefficient" regulations on commerce to further other goals, such as fairness to all shareholders. In *Exxon,* the fact that a State law altered "the natural functioning of the interstate market" was unimportant because the Commerce Clause does not protect "the particular structure or methods of operation" in a market. 437 U.S. at 127. Thus, Maryland was entitled to protect independent service station operators even if it was not "economically efficient" to do so.

The Seventh Circuit's concern about the efficient use of corporate assets here – like the plaintiffs' argument in *Exxon* – "relates to the wisdom of the statute, not to its burden on commerce." 437 U.S. at 128. The efficiency argument should therefore be addressed to the Indiana legislature, not to the Federal courts. Indeed, the Seventh Circuit's entire "interstate market for corporate control" theory is but a thinly disguised variation on the "novel suggestion," rejected in *Exxon,* that "because the economic market for petroleum products is nationwide, no State has the power to regulate the retail marketing of gas." 437 U.S. at 128.

Equally important, Judge Posner's reasoning fails to realize that the "market for corporate control" is a market *created only by State law defining property rights and ownership interests.* The "market" exists at all only because Indiana and other States (acting under no "Commerce Clause" or other constitutional compulsion) have enacted laws that create corporations in the first

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adopting a "one shareholder, one vote" rule today, even though such a rule would make it difficult – if not impossible – for a hostile takeover bidder to acquire control of that State's corporations.

place, and then permit them to issue equity securities that may then in turn be bought and sold. As Chief Justice Marshall explained long ago:

> A corporation is an artificial being, invisible, intangible, and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence.

Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518, 636 (1819). *State* law defines the terms of the contract among the corporation, its shareholders and the State, and thereby (as is true of all State-created property interests) *defines* any interest that is available for sale, whether in interstate commerce or otherwise.[22]

Moreover, nothing in this Court's Commerce Clause decisions even suggests that the States may not, in exchange for the privileges of the corporate franchise, impose conditions on those privileges – including limits on the transfer of voting power that do not discriminate against interstate commerce. Indeed, this Court has upheld similar limits. For example, in *Louisville & Nashville R.R v. Kentucky,* 161 U.S. 677 (1896), this Court upheld

[22] Ironically, the same panel of the Seventh Circuit that decided the case now before this Court recognized, in deciding a later appeal involving CTS's second shareholder rights plan, that the Commerce Clause does not invalidate contractual relationships among shareholders governed by State corporation law. Thus, in rejecting as "frivolous" DCA's argument that Indiana law violated the Commerce Clause by allowing defensive tactics by the boards of directors of its domestic corporations, the panel stated: "The commerce clause does not require states to outlaw private contracts that may impede interstate commerce." *Dynamics Corp. of America v. CTS Corp.,* No. 86-1888, slip op. at 23 (7th Cir. Nov. 3, 1986). The Control Share Chapter itself, however, involves nothing more than such a "private contract" among the shareholders with respect to voting rights – particularly since Indiana corporations are given the choice of "opting-out" of the Control Share Chapter. *See* IND. CODE § 23-1-42-5.

against a Commerce Clause challenge a State's prohibition on a State-chartered railroad's purchase of competing railroads:

> As the power to purchase, then, is derivable from the state, *the state may accompany it with such limitations as it may choose to impose.* It results, then, from the argument of the appellant, that if there be any interference with interstate commerce *it is in imposing limitations upon the exercise of a right which did not previously exist*; and hence, if the state permits such purchase or consolidation, it is bound to extend the authority to every possible case, or expose itself to the charge of interfering with commerce. *This proposition is obviously untenable.*

161 U.S. at 702-03 (emphasis added).[23]

The lesson of these cases is clear: Absent discrimination against interstate commerce, nothing in the Commerce Clause requires the States to define corporate property rights and ownership interests in particular ways. More generally, the fact that alternative legal definitions of property might lead to a larger "interstate market" in the property as redefined does not, even if proven, establish a Commerce Clause violation. For example, it could not credibly be argued that a State law permitting private ownership of handguns but forbidding their sale violates the Commerce Clause, even though such a statute would reduce the "amount" of interstate (as well as intrastate) commerce in that property.

DCA's Commerce Clause contentions do nothing to alter this conclusion. The essence of DCA's argument is that the Control Share Chapter violates the Commerce Clause because DCA is an out-of-State corporation and its tender offer involved interstate commerce. Neither fact, however, raises any constitutional issue with respect to a State statute that *also* applies to any *in*-State takeover bidder, and *also* applies to a tender offer (or other acquisition) involving wholly *intra*state commerce. In short, DCA seeks not the absence of discrimination that the Commerce Clause ensures, but rather claims some right to special treatment simply because its takeover bid involved interstate commerce. Justice Holmes long ago rejected that argument for the Court: "A man cannot acquire a right to property by his desire to use it in commerce among the States. Neither can he enlarge his otherwise limited and qualified right to the same end." *Hudson County Water Co. v. McCarter,* 209 U.S. 349, 357 (1908). Likewise, while the Commerce Clause may prohibit Indiana from discriminating against DCA because it is an out-of-State corporation, it does not entitle DCA to special privileges arising from its non-resident status.

The Seventh Circuit's various comments about the wisdom of the economic policy judgments reflected in the Control Share Chapter are also of no constitutional moment under the Commerce Clause. For example, the Seventh Circuit characterized the belief that "hostile takeovers are bad" as "benighted," while describing "commerce in corporate control" as "important." (CTS App. at A22, A26.) Both comments reflect a profound misunderstanding of the Commerce Clause and the role of the Federal courts in applying it. There may indeed cur-

[23] Similarly, this Court has often recognized that the law of the State of incorporation defines and creates corporate property rights, and therefore must govern relationships among shareholders and the corporation. For example, in *Modern Woodmen of America v. Mixer,* 267 U.S. 544, 551 (1925), the Court held that the Full Faith and Credit Clause required the forum State court to apply the law of the State of incorporation, and not its own, to determine the rights of a shareholder. Accordingly, the *Modern Woodmen* Court upheld a limitation on a shareholder's rights imposed by the law of the State of incorporation: "The act of becoming a member is something more than a contract, it is entering into a complex and abiding relation, and as marriage looks to domicil, membership looks to and must be governed by the law of the State granting the incorporation." *Id. Accord, e.g., Royal Arcanum v. Green,* 237 U.S. 531, 546 (1915); *Head & Amory v. Providence Ins. Co.,* 6 U.S. (2 Cranch) 127, 167 (1804).

rently exist, as a practical matter, a familiar market in "corporate control." Indiana has simply chosen, however, as a matter of its generic corporation law, to give shareholders of its domestic corporations new rights vis-a-vis potentially dominant new shareholders. Whether the Seventh Circuit found this new type of law unsettling, unwise or even "benighted," it overlooked that:

> Some . . . laws embody convictions which judges are likely to share. Some may not. But a Constitution is not intended to embody a particular economic theory, whether of paternalism and the organic relation of the citizen to the state or of *laissez faire*. It is made for people of fundamentally differing views, and the accident of our finding certain opinions natural and familiar, or novel, and even shocking, ought not to conclude our judgment upon the question whether statutes embodying them conflict with the Constitution of the United States.

Lochner v. New York, 198 U.S. 45, 75-76 (1905) (Holmes, J., dissenting). And, as noted earlier, this Court's decision in *Exxon* makes clear that the Commerce Clause does not require the States to continue to maintain economically "efficient" markets, even where interstate commerce is in some sense "affected." *See* L. TRIBE, AMERICAN CONSTITUTIONAL LAW 25 (Supp. 1979) (discussing *Exxon*); *New State Ice Co. v. Liebmann,* 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting) ("[i]t is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country").

In fact, the Seventh Circuit's comments about "benighted" views and "important" commerce in corporate control reflect but one side of a long-standing and substantial debate over the value of the extensive hostile takeover activity in the American economy – a debate intensified in just the last few weeks by renewed attention focused on the role of the arbitrage community. The very existence of that debate, however, supports Indiana's right to

undertake the economic experiment of the Control Share Chapter. If the Seventh Circuit's economic analysis were correct, one might reasonably expect the market price for shares in Indiana corporations to drop. If that should occur – and whether it will is highly questionable – it would harm only Indiana and thus raise no Commerce Clause issue. *See Raymond Motor Transportation, Inc. v. Rice,* 434 U.S. 429, 444 n.18 (1978). Indeed, Indiana's allegedly "benighted" experiment, if it should prove to be such, may save the rest of the States or Congress from making the same mistake on a much larger and costlier scale. That is precisely the view of economic Federalism that Justice Brandeis praised in *New State Ice.*[24]

The Seventh Circuit's disregard of these fundamental principles of Federalism – and its substitution of its own economic policy analysis for Commerce Clause

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[24] Equally insignificant for Commerce Clause purposes is the claim – implied by the Seventh Circuit (CTS App. at 25) and overtly argued by DCA (Motion To Affirm at 16, 18) – that the Indiana statute "protects" incumbent management of Indiana corporations. Even if that were the purpose or effect of the statute – a debatable proposition on which there is no record evidence, *see* note 13, *supra* – it is *not* the sort of "economic protectionism" *between States* that the Commerce Clause forbids, any more than was the "economic protectionism" of independent service station operators upheld in *Exxon.* Absent "protectionism" directed at its sister States, Indiana is free to make the legislative judgment that leaving corporations wide open to corporate raiders leads to undesirable economic results – with incumbent management focusing only upon short-term results and the current market price of the corporation's stock, rather than undertaking economically rational risks and investments that pay off only in the longer term. *See, e.g.,* Lowenstein, *Pruning Deadwood In Hostile Takeovers: A Proposal For Legislation,* 83 COLUM L. REV. 249, 291-306 (1983). Even if the Commerce Clause *did* impose any "economic inefficiency" constraint on State legislative action (and it does not), it certainly does not impose a *particular school* of economic thought on the States of this Nation.

jurisprudence – are highlighted by its twin statements that the fact "that the mode of [State] regulation involves jiggering with voting rights cannot take it outside the scope of [Federal] judicial review," and that any other conclusion would invite "facile evasions" of the Commerce Clause. (CTS App. at A27). Neither statement is correct.

Both the Constitution in general and the Commerce Clause in particular are precisely concerned with which "mode[s]" of regulation are the province of the Federal Government and which are the province of the States. The proper focus of constitutional inquiry is where the Constitution places the power to act – an inquiry that does not turn on whether regulation will or will not yield a given economic result in a particular case. *Cf. Synar v. United States,* 626 F. Supp. 1374, 1403 (D.D.C.) ("the balance of separated powers established by the Constitution consists precisely of a series of technical provisions that are more important to liberty than superficially appears, and whose observance cannot be approved or rejected by the courts as the times seem to require"), *aff'd sub nom. Bowsher v. Synar,* 478 U.S. ___, 92 L. Ed. 2d 583 (1986). A State statute of the kind at issue here – regulating (as the States have traditionally and exclusively done) the voting power of shares in corporations created by that State – is not invalid simply because one of its effects may be to make the purchase of such shares less attractive as an *economic* proposition for a prospective acquirer. Whether the Commerce Clause is "honored" or "evaded" depends not on whether a given economic outcome is reached, but rather on whether the Federal Government and the States are acting within their respective spheres of constitutional authority.

Moreover, the logic of the Seventh Circuit's contrary Commerce Clause reasoning points (like its preemption analysis) inexorably in one direction: Any aspect of State corporation law that may make it harder to take over voting control of a domestic corporation violates the Commerce Clause. While the Seventh Circuit "assume[d] without having to decide that Indiana has a broad latitude in regulating [the internal affairs of its corporations], even when the consequence may be to make it harder to take over an Indiana corporation" (CTS App. at A27), its reasoning in fact has no stopping point. It reaches any aspect of State corporation law that may discourage a takeover: The Seventh Circuit articulated no logical distinction between such laws, and none exists. If a State may not "jigger with voting rights," there is no reason why it may "jigger" with the scheduling and voting methods for electing directors, fiduciary standards applicable to takeover defenses, restrictions on freeze-out or back-end mergers that may injure minority shareholders, or any other aspect of State corporation law that may annoy a given tender offeror.

But the Commerce Clause does not reach so far. Because the Control Share Chapter neither discriminates against interstate commerce nor creates a threat of multiple and inconsistent burdens, Indiana remains free to try this economic experiment in protecting the interests of non-dominant shareholders in the corporations it creates.

CONCLUSION

In view of the wide-spread policy debate over the desirability of hostile corporate takeovers and the prospect of unlimited Federal intrusion into State corporation law, the appropriate balancing of State and Federal regulation should be left to the political judgments of State legislatures and the Congress. To date, the Congress has involved itself in tender offer regulation only to the limited extent of the Williams Act, which does not even begin to address the subjects covered by the Control Share Chapter. Unless and until Congress speaks to the contrary, Indiana should be permitted to proceed with an economic experiment that does not conflict with the Williams Act, and neither discriminates against interstate commerce nor extends beyond its own corporations.

This Court should therefore reverse the judgment below.

December 3, 1986.

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